

ORDER NO. 4685

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Chairman;
Tony Hammond, Vice Chairman;
Mark Acton; and
Nanci E. Langley

Periodic Reporting
(Proposal Four)

Docket No. RM2018-7

NOTICE OF PROPOSED RULEMAKING ON ANALYTICAL PRINCIPLES
USED IN PERIODIC REPORTING (PROPOSAL FOUR)

(Issued June 28, 2018)

I. INTRODUCTION

On June 25, 2018, the Postal Service filed a petition pursuant to 39 CFR 3050.11, requesting that the Commission initiate a rulemaking proceeding to consider changes to analytical principles relating to periodic reports.¹ The Petition identifies the proposed analytical principles changes filed in this docket as Proposal Four.

II. PROPOSAL FOUR

Background. Proposal Four would change the costing methodology for assigning expenses related to debit card transactions in the component named Retail Credit Card

¹ Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), June 25, 2018 (Petition).

Fees (Component No. 126) in Cost Segment 13. Petition, Proposal Four at 1. Debit card transactions, which are purchases made using debit cards, incur fees that merchants pay to the debit card issuer.² For example, when a customer purchases a product or service from the Postal Service using a debit card, the Postal Service pays the debit card issuer a fee for each transaction.

In Docket No. RM2015-4, the Commission approved the current methodology for assigning expenses related to credit and debit card transactions.³ The current methodology treats these expenses as fully volume variable and assigns them to products in the same proportions as the Postal Service revenue realized from aggregate credit and debit card transactions. Petition, Proposal Four at 1. When preparing the FY 2017 Annual Compliance Report (ACR), the Postal Service explains that it recognized two flaws in the current methodology. *Id.* First, the current methodology uses the total of both credit and debit card fees when calculating distribution factors. *Id.* This assumes that transactions made with debit and credit cards are similar, which is not true for every product. *Id.* For example, Priority Mail generates more revenue from credit card purchases than debit cards. *Id.* Conversely, Money Orders cannot be purchased using credit cards. *Id.*

The Postal Service asserts that when calculating a distribution key, the type of card used (debit or credit) becomes more important because total credit card fees are almost four times greater than total debit card fees. *Id.* Because of this incorrect assumption, the current methodology misallocates expenses related to debit and credit card fees, especially for products that are more heavily purchased by one card type. *Id.*

² One type of fee that may be incurred when using a debit card is an interchange fee, which is the largest categorical contributor to total debit card processing fees for a transaction. *Id.* at 5. A merchant pays an interchange fee to the debit card issuer whenever a customer makes a purchase using a debit card. See 12 CFR 235.2(j) (defining “interchange transaction fee” as “any fee established, charged, or received by a payment card network and paid by a merchant or an acquirer for the purpose of compensating an issuer for its involvement in an electronic debit transaction.”). The debit card fees referred to in the Petition and this Order are interchange fees.

³ Petition, Proposal Four at 1; see Docket No. RM2015-4, Order Approving Analytical Principle Used in Periodic Reporting (Proposal Eleven), February 9, 2015 (Order No. 2350).

The second flaw in the current methodology identified by the Postal Service is that the distribution factors do not fully align with actual expenses incurred from the usage of debit and credit cards. *Id.* at 2. For example, for Money Order transactions, the Postal Service charges the customer the face value of the Money Order plus a Special Services fee. *Id.* When calculating the Money Order share of total “revenue” for distribution purposes, the current methodology only considers the Special Services fee the Postal Service charges the customer. *Id.* The Postal Service asserts that this methodology is erroneous because the amount the Postal Service pays to the debit card provider is based on the entire transaction amount, including the face value of the money order, rather than just the Special Services fee charged. *Id.*

To address these two flaws in the current methodology, the Postal Service made two corrections to Library Reference USPS-FY17-32, which was filed with the FY 2017 ACR.⁴ First, the Postal Service separated credit and debit card fees to develop different sets of distribution factors for these fees. Petition, Proposal Four at 2. Second, the set of distribution factors for debit cards used the aggregate face value of Money Orders purchased with debit cards in conjunction with the revenue from all other products. *Id.*

In a supplemental Chairman’s Information Request (CHIR) response, the Postal Service proposed a model attempting to account for the recognized major components of debit card fees.⁵ In the FY 2017 Annual Compliance Determination (ACD), the Commission stated that the proposed model was not an approved methodology for

⁴ *Id.*; see Docket No. ACR2017, Library Reference USPS-FY17-32, December 29, 2017.

⁵ *Id.* at 2-3; see Docket No. ACR2017, Supplemental Response of the United States Postal Service to Question 1.b of Chairman’s Information Request No. 2, February 23, 2018 (Response to CHIR No. 2, Question 1.b).

attributing expenses related to debit card fees.⁶ It directed the Postal Service to continue investigating issues related to debit card fee attribution and update the Commission on its progress and any potential corresponding methodological changes within 90 days after the ACD was issued. FY 2017 ACD at 64. The Postal Service asserts that Proposal Four is a result of this investigation. Petition, Proposal Four at 3.

Proposal description. Proposal Four would change the methodology for assigning expenses related to debit card transactions (Debit Card Expenses). Proposal Four would disaggregate total Debit Card Expenses into two cost pools: Transactions and Proceeds. *Id.* The Transactions cost pool would account for Debit Card Expenses for regulated transactions, which have limits on debit card fee amounts based on Federal Reserve regulations. *Id.* at 3, 5. Unregulated transactions do not have these limits. *Id.* at 5.

To calculate the amount of Debit Card Expenses allocated to the Transactions cost pool, the Postal Service would first determine the number of regulated debit card transactions. *Id.* at 3. This is the total number of debit card transactions multiplied by the proportion of regulated transactions. The number of regulated transactions would then be multiplied by the approximate per-transaction cost to calculate the amount of Debit Card Expenses allocated to the Transactions cost pool.⁷ The remaining amount would be allocated to the Proceeds cost pool. Petition, Proposal Four at 4.

For example, in FY 2017, total Debit Card Expenses were approximately \$58.6 million. *Id.* at 3. Proposal Four would disaggregate these expenses between the Transactions cost pool and Proceeds cost pool. There were approximately 150 million debit card transactions, 65 percent of which were regulated. *Id.* at 3-4. The approximate per-transaction cost was 22 cents. *Id.* at 4. Thus, the Transactions cost

⁶ Docket No. ACR2017, Annual Compliance Determination, March 29, 2018, at 64 (FY 2017 ACD). The Commission's rules require the Postal Service to use only accepted analytical principles in its annual periodic reports to the Commission, including the ACR. 39 CFR 3050.10.

⁷ *Id.* at 3-4. As discussed below, the "per-transaction" cost appears to refer to fixed debit card fees, which are the same for each transaction regardless of the transaction amount. See Response to CHIR No. 2, Question 1.b.

pool would equal approximately \$21.3 million (150 million total debit card transactions x 65 percent regulated transactions x 22 cents per-transaction cost). *Id.* The remaining amount of \$37.3 million (\$58.6 million - \$21.3 million) would be allocated to the Proceeds cost pool. *Id.*

Under Proposal Four, Debit Card Expenses in the Transactions cost pool would be assigned to products proportionally based on the number of tenders captured from the Retail Data Mart. *Id.* Debit Card Expenses in the Proceeds cost pool would be assigned to products in proportion to the total proceeds realized with debit cards, which is the same distribution key used under the current methodology. *Id.* The final Debit Card Expenses assigned to each product would be the sum total of the respective amounts from each cost pool. *Id.*

The Postal Service states that Proposal Four reflects the proposed model presented in Docket No. ACR2017. *Id.* However, it explains that Proposal Four differs by distinguishing between regulated and unregulated transactions. *Id.* By contrast, the proposed model assumed that all of the debit card transactions were regulated. *Id.*

Rationale. The Postal Service asserts that Proposal Four would improve the accuracy of its costing methods by more closely reflecting how debit card fees are incurred. *Id.* at 4-5. Debit card fees generally have two components: a fixed fee per transaction (regardless of transaction amount) and a variable fee that changes based on the transaction amount. Response to CHIR No. 2, Question 1.b. For regulated transactions, the Federal Reserve limits debit card fees to 22 cents per transaction (fixed fee) plus 0.05 percent of the transaction (variable fee).⁸ Proposal Four would account for the fixed debit card fees in the Transactions cost pool for regulated transactions. *Id.* The Proceeds cost pool would account for the variable debit card fees along with other fees, including fees for unregulated debit card transactions. *Id.*

The Postal Service asserts that Proposal Four would address a flaw in the current methodology. *Id.* at 6. The current methodology assigns all Debit Card

⁸ Petition, Proposal Four at 5. The 22 cent per-transaction cost includes one cent for fraud protection costs. *Id.*

Expenses to products in the same proportions as the Postal Service revenue realized from aggregate debit card transactions. *Id.* at 1. However, this methodology ignores the fixed “per-transaction” component of Debit Card Expenses.⁹ The current methodology would be appropriate if all products had the same average revenue per transaction. Petition, Proposal Four at 6. Because they do not, products with below average revenues per transaction are assigned less than their appropriate share of the Debit Card Expenses related to the fixed fee. *Id.* Conversely, products with above average revenues per transaction are assigned more than their share of these expenses. *Id.*

For example, the average revenue per transaction for Money Orders is substantially higher than those of other products. *Id.* at 7. The Postal Service asserts that the current methodology overstated the Debit Card Expenses assigned to Money Orders in FY 2017. *Id.* at 6-7. The Postal Service points out that applying Proposal Four would have properly distinguished between the fixed per-transaction and residual components for regulated transactions, which would have resulted in a more accurate assignment of Debit Card Expenses to Money Orders. *Id.* at 7. The Transactions cost pool would account for the fixed per-transaction component of Debit Card Expenses. *See id.* at 4. The Postal Service concludes that adopting Proposal Four would improve the accuracy of its costing methods by more closely aligning with the way debit card fees are incurred. *Id.*

Impact. The Petition includes a table illustrating the cost impacts of Proposal Four. *Id.* at 7-8. This table compares the Debit Card Expenses distribution as presented in the FY 2017 ACR with the distributions that would have resulted if Proposal Four had been used. *Id.* at 7. The Postal Service explains that the most significant change to the cost coverages filed with the FY 2017 ACR would be to Money Orders, which would have experienced an increase in cost coverage under Proposal

⁹ *Id.* at 6. The “per-transaction” component appears to refer to fixed debit card fees, which are the same for each transaction regardless of the transaction amount. *See* Response to CHIR No. 2, Question 1.b.

Four from 97 percent to approximately 107 percent. On a unit cost basis, the impact on all other products “would be either trivial or, in most instances, entirely immaterial.” *Id.* at 7-8. The Postal Service provides further details in workpapers filed with the Petition.¹⁰

III. NOTICE AND COMMENT

The Commission establishes Docket No. RM2018-7 to consider matters raised by the Petition. More information on the Petition may be accessed via the Commission’s website at <http://www.prc.gov>. Interested persons may submit comments on the Petition and Proposal Four no later than July 23, 2018. Pursuant to 39 U.S.C. 505, Jennaca D. Upperman is designated as an officer of the Commission (Public Representative) to represent the interests of the general public in this proceeding.

IV. ORDERING PARAGRAPHS

It is ordered:

1. The Commission establishes Docket No. RM2018-7 to consider matters raised by the Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), filed June 25, 2018.
2. Comments by interested persons in this proceeding are due no later than July 23, 2018.
3. Pursuant to 39 U.S.C. 505, the Commission appoints Jennaca D. Upperman to serve as an officer of the Commission (Public Representative) to represent the interests of the general public in this docket.

¹⁰ See Petition, Excel file “Prop.4.Debit.Card.Attachment.xlsx.”

4. The Secretary shall arrange for publication of this Order in the *Federal Register*.

By the Commission.

Stacy L. Ruble
Secretary